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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Joseph B. Kauffman hereby petitions that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in this action on September 24, 1970 and amended herein on November 12, 1970.

OPINIONS BELOW.

The opinion of the District Court is not officially reported and is printed in the Appendix, pp. A3-A8. The opinion of the Court of Appeals is not yet officially reported and is printed in the Appendix, pp. A12-A26.

JURISDICTION.

The judgment of the Court of Appeals for the Third Circuit was entered on September 24, 1970, Appendix, p. A27, and amended on November 12, 1970, Appendix, pp. A30-A31. On October 20, 1970, petitioner's timely petition for rehearing was denied, with two of the seven judges of the circuit in regular active service not participating in its consideration, Appendix, p. A29.[1] The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

A. Does a customer-shareholder[2] of four mutual funds have standing to sue *in his own right* under Section 4 of the Clayton Act, 15 U. S. C. § 15, for damages which he sus-

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1. Although the Order sur petition for rehearing, Appendix, p. A29, indicates that only Judge Freedman did not participate, it appears that Judge Adams also did not participate.

2. Petitioner is referred to as a "customer-shareholder" because, unlike any shareholders of other corporations, persons who invest in mutual funds simultaneously are *customers* as well as shareholders, purchasing the *only* product of mutual funds, namely investment advice and diversity of investment risk, through the conduit of their investment in mutual funds.

tained as a result of violations of Sections 1 and 2 of the Sherman Act, 15 U. S. C. § 1 and § 2, where:

1. As a customer, he has been directly injured by defendants' antitrust violations?

2. The Investment Company Act of 1940, 15 U. S. C. §§ 80a-1 *et seq.*, which was expressly enacted for the benefit of customer-shareholders of mutual funds, and decisions thereunder, establish that a customer-shareholder of mutual funds has standing to sue *in his own right* as well as derivatively for *any* violations of law involving mutual funds?

B. Whether the conflict among the Courts of Appeals regarding standing to sue under Section 4 of the Clayton Act should be resolved by following the holdings of the Second and Third Circuits, which turn on the directness or indirectness of harm to the injured party, or by following the holdings of the Fourth, Eighth and Ninth Circuits, which refer to the location of the injured party within or without the "target area"?

C. Whether standing to sue under Section 4 of the Clayton Act should be more limited than standing to challenge administrative regulations promulgated by governmental agencies?

D. Under this Court's decision in *Ross v. Bernhard*, 396 U. S. 531 (1970), does a customer-shareholder of four mutual funds have standing to sue not only derivatively on behalf of his four funds but to exercise the conceded right of said four funds to commence a class action on behalf of all other mutual funds similarly situated in light of the importance of class actions to:

1. Effective enforcement of the antitrust laws by private parties?

2. Discouragement of a multiplicity of suits based on a wrong common to all members of a class similarly situated?

STATUTORY PROVISIONS INVOLVED.

The statutory provisions involved herein are Section 4 of the Clayton Act, Sections 1 and 2 of the Sherman Act and Section 1(b) of the Investment Company Act of 1940.

Section 4 of the Clayton Act, 15 U. S. C. § 15, provides:

> "Any person who shall be injured in his business or property *by reason of anything forbidden in the anti-trust laws* may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." (Boldface and emphasis supplied.)

Section 1 of the Sherman Act, 15 U. S. C. § 1, provides in pertinent part:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . ."

Section 2 of the Sherman Act, 15 U. S. C. § 2, provides in pertinent part:

> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty . . ."

Section 1(b) of the Investment Company Act of 1940, 15 U. S. C. § 80a-1(b), provides in pertinent part:

> "Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission

made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is declared that the national public interest and the interest of investors are adversely affected—

* * *

"(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders."

STATEMENT OF THE CASE

This action was instituted by petitioner, *inter alia*, under Section 4 of the Clayton Act, 15 U. S. C. § 15, for treble damages. The gravamen of petitioner's action was that defendants have engaged in a combination and conspiracy, with horizontal and vertical agreements, to fix management fees and to refrain from competition for the business of advising mutual funds and the business of obtaining investment advice in violation of Sections 1 and 2 of the Sherman Act, 15 U. S. C. § 1 and § 2.

Petitioner, as a customer-shareholder of four mutual funds, commenced this suit both as a representative and as a derivative action against 65 mutual funds as nominal defendants, 38 investment advisers managing said 65 mutual funds, 37 self-dealing directors sitting simultaneously as directors or trustees of said 65 funds and 38 investment advisers, and the trade association representative for the mutual fund industry.

At the threshold, defendants moved to dismiss, *inter alia*, all antitrust claims commenced by petitioner *in his own right* on the ground that he lacked standing to sue since all the claims asserted by him were necessarily derivative in nature. Invoking traditional concepts of the shareholder-corporation relationship, defendants contended that petitioner could not maintain any antitrust claims *in his own right* since he was harmed only indirectly.

However, since mutual funds, unlike all other corporations, *must* redeem their shares at the option of their shareholders at *net asset value*, each shareholder of a mutual fund *owns* a proportionate share of the net assets of his fund represented by the number of shares owned by him at any particular time as compared to the total number of shares then outstanding.[3] Arthur Wiesenberger Serv-

3. In order to arrive at a net asset figure, all liabilities, including management fees, are subtracted from gross assets.

ices, Investment Companies, p. 17 (1969 Ed.); Wharton School of Finance and Commerce, A Study of Mutual Funds, p. 6 (1962). Furthermore, defendants' motions ignored the critical economic fact that, unlike any other corporation, the customers buying the services of mutual funds and the shareholders of mutual funds are *identical*. Thus, petitioner's action focused on grossly excessive management fees, or the *charge* to mutual fund customer-shareholders for obtaining diversity of investment risk and professional management through the conduit of their mutual fund investments. *Hearings, Mutual Fund Legislation of 1967*, Part 2, p. 672; *Hearings, Mutual Fund Amendments of 1969*, Part 1, p. 430.

Moreover, defendants contended that petitioner could not maintain his suit as a class action on behalf of the 61 mutual funds in which he did not own shares.

The District Court denied defendants' motions, but certified its decision for appeal pursuant to 28 U. S. C. § 1292(b); Appendix, pp. A3-A9. The Court of Appeals permitted defendants to appeal, Appendix, p. A10, and, subsequently, reversed the District Court, holding *as a matter of law* that:

1. Petitioner could not maintain a claim in his own right under Section 4 of the Clayton Act because he was a shareholder (Appendix, pp. A15-A18); and

2. Petitioner could not bring a class action on behalf of the 61 mutual funds in which he did not own any shares (Appendix, pp. A19-A24), even though he had a right to bring a derivative action on behalf of the four mutual funds in which he owned shares (Appendix, p. A19) and even though those funds had the right to commence an action on behalf of all other funds similarly situated (Appendix, p. A24).

In short, the Third Circuit summarily dismissed petitioner's claims *as a matter of law* without according him *any* opportunity for discovery on the merits and, concomitantly, without according him *any* opportunity to demonstrate the propriety of his standing to sue in his own right under Section 4 of the Clayton Act. Significantly, the decision of the Third Circuit conflicts with this Court's repeated admonition to eschew summary dismissals of antitrust claims, *Norfolk Monument Co., Inc. v. Woodlawn Memorial Gardens, Inc.*, 394 U. S. 700, 704 (1969), *Poller v. Columbia Broadcasting System, Inc.*, 368 U. S. 464, 473 (1962), and to avoid decisions which disregard "the economic reality of the relevant transactions." *United States v. Concentrated Phosphate Export Assn., Inc.*, 393 U. S. 199, 208 (1968).[4]

4. The Third Circuit totally ignored the economic reality that shareholders of mutual funds are *customers* as well as shareholders.

REASONS FOR GRANTING THE WRIT.

A. This Petition Raises Important Questions Regarding Private Enforcement of Antitrust Policy.

As declared by this Court in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U. S. 134, 139 (1968), "the purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws." Accordingly, this Court has always emphasized approaches which effectuate, rather than emasculate, private enforcement of antitrust policy:

> "The statute does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers . . . . *The Act is comprehensive in its terms and coverage*, protecting all who are made victims of the forbidden practices by whomever they may be perpetrated." *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U. S. 219, 236 (1948). (Emphasis and boldface supplied.)
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> "Congress has, by legislative fiat, determined that such prohibited activities are injurious to the public and has provided sanctions allowing private enforcement of the antitrust laws by an *aggrieved party* . . . In the face of such a policy *this Court should not add requirements to burden the private litigant beyond what is specifically set forth by Congress in those laws.*" *Radovich v. National Football League*, 352 U. S. 445, 453-454 (1957). (Footnote omitted and emphasis supplied.)

Indeed, as recently recognized by the Ninth Circuit in *Mulvey v. Samuel Goldwyn Productions*, 1970 Trade Cases ¶ 73,361 at p. 89,450 (1970):

"We turn to Goldwyn's standing argument. In pertinent part, section 4 of the Clayton Act provides: 'Any person who shall be injured in his . . . property *by reason of* anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages by him sustained . . .' (Emphasis added.) The italicized language has been judicially construed to embrace not only the legal causation element, but also the standing concept, which in this setting is a close relative of causation. *It is a relationship that has not received a blessing by the Supreme Court.*" (Emphasis supplied.)

Nonetheless, several Courts of Appeals have construed Section 4 of the Clayton Act as incorporating a standing prerequisite. Both the Third Circuit and the Second Circuit have adopted a restrictive standing test which turns on whether or not the plaintiff has been directly injured. If it is determined that the plaintiff has been indirectly injured, standing is denied and the complaint is dismissed, irrespective of the fact that plaintiff has been injured and has a meritorious claim. See, *e.g.*, *Fields Productions, Inc. v. United Artists Corp.*, 1970 Trade Cases ¶ 73,329 (2d Cir. 1970); *Billy Baxter, Inc. v. Coca-Cola Co.*, 431 F. 2d 183 (2d Cir. 1970).

In the Court of Appeals, petitioner contended, *inter alia*, that the grossly excessive management fees charged mutual funds by investment advisers *necessarily* reduced on a *pro rata* basis the net asset value of his shares because of his undisputed right at any time to redeem his shares at net asset value. Although the Court of Appeals accepted this factual contention, as it must at this stage of the proceedings in considering a motion to dismiss, it denied him standing to sue solely on the ground that it could not alter the traditional concepts of the shareholder-corporation relationship (Appendix, p. A16):

> "That the worth of a share of appellee's stock is directly proportionate to the value of a mutual fund's net assets is insufficient to destroy these separate identities, to alter the basic shareholder-corporation relationship, and to thereby confer upon appellee legal rights peculiar to the corporation."

By applying the antitrust laws on the basis of rigid, artificial concepts of corporation law and by disregarding petitioner's status as a *customer* as well as a shareholder, contrary to this Court's decision in *United States v. Concentrated Phosphate Export Assn., Inc., supra*, which directed lower courts to base their decisions on "the economic reality of the relevant transactions," the Court of Appeals concluded that petitioner's shareholder status deprived him of standing to sue in his own right, although he was a "person . . . injured in his business or property" (Appendix, pp. A17-A18):

> "It being established that appellee's alleged injury is by definition 'indirect,' his attempt to prosecute this action in his own right, as a shareholder, cannot succeed. Efforts to characterize the harm as 'direct,' or, argument that 'proximate harm' is sufficient or that appellee is 'within the sector of the economy in which the violation threatened a breakdown of competitive conditions,' *South Carolina Council of Milk Products, Inc. v. Newton*, 360, F. 2d 414, 418 (4th Cir.), *cert. denied* 385 U. S. 934 (1966), are simply unavailing in light of *Ash*. Indeed, appellee has cited no case in which a shareholder has achieved standing to remedy the type of harm portrayed here."

On the other hand, both the Fourth and Ninth Circuits have adopted the more liberal "target area" test in determining whether or not a plaintiff has standing to sue under

Section 4 of the Clayton Act. Under this test, no single or exclusive cause of action is created and standing is conferred on all plaintiffs who are within "the area which it could reasonably be foreseen would be affected" by the antitrust violations, irrespective of the indirectness of the injury. See, *e.g.*, *Mulvey v. Samuel Goldwyn Productions*, *supra*; *South Carolina Council of Milk Producers, Inc. v. Newton*, 360 F. 2d 414 (4th Cir. 1966) *cert. denied* 385 U. S. 934 (1966).

In *Mulvey*, *supra*, the Ninth Circuit held that, under Section 4 of the Clayton Act, a seller of five motion pictures had standing to sue his purchaser for block booking his movies to television since it was "entirely foreseeable that [his purchaser's] block booking could impair the profit potential of [the seller's] films, thus depreciating the value of [the seller's] contractual interest in the film's revenue." 1970 Trade Cases ¶ 73,361 at p. 89,450.

Similarly, the Fourth Circuit in *South Carolina Council*, *supra*, held that an association of milk producers had standing to sue under Section 4 of the Clayton Act even though the milk producers did *not* sell directly to defendants, defendants were *not* producers in competition with the milk producers, and the milk producers' commodity was *raw* milk whereas defendants' commodity was processed milk. In short, the Fourth Circuit established a standing test which disregarded legal form for economic substance.

Finally, the Eighth Circuit in *Sanitary Milk Producers v. Bergjans Farm Dairy, Inc.*, 368 F. 2d 679 (8th Cir. 1966) adopted a standing test which is virtually identical to the causation criterion of Section 4 of the Clayton Act. There, defendants attacked Bergjans' standing to sue because it was a processor that sold *all* of its production to an identically owned sales company, which was *not* a party therein. Relying on the nature of the relationship between Bergjans

and its sales company, the Court held that Bergjans' injury was nevertheless cognizable under Section 4 of the Clayton Act and that "it would be less than realistic to say that Bergjans is not one which § 4 of the Clayton Act, 15 U. S. C. § 15, is designed to protect." 368 F. 2d at 689.

The incorporation of a restrictive standing test as a prerequisite to the invocation of Section 4 of the Clayton Act obviously dilutes, if not destroys, "the effectiveness of the private action as a vital means for enforcing the antitrust policy of the United States." *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U. S. at 136.

In *Perkins v. Standard Oil Co. of California*, 395 U. S. 642, 647 (1969), this Court indicated that the imposition of artificial limitations on Section 2 of the Clayton Act, 15 U. S. C. § 13, were "completely unwarranted by the language or purpose of the Act." Thus, despite the fact that the plaintiff, a competitor of a customer of a customer of a customer of a supplier, was remotely located on the "fourth level," he was permitted to maintain his action (395 U. S. at 648):

> "From Perkins' point of view, the competitive harm done him by Standard is certainly no less because of the presence of an additional link in this particular distribution chain from the producer to the retailer."

In conclusion, this Court should grant this petition in order to resolve the conflict among the Courts of Appeals in construing Section 4 of the Clayton Act and in order to squarely address itself to the issue raised by Judge Waterman in his cogent dissent in *Billy Baxter* (431 F. 2d at 191):

> "There seems to have emerged from a major portion of the cases interpreting the antitrust statutes a talismanic rule of lack-of-standing, presumably based in

some fashion upon those now famous words 'by reason of.' If the plaintiff suffers injury from the defendant's illegal antitrust conduct, but the plaintiff is somehow separated from the defendant by the presence of an intermediate person who has also fallen victim to that conduct, the plaintiff's injury is given the label of an 'indirect,' 'remote,' or 'consequential' injury. The label then dictates the outcome of the case and the plaintiff is denied a recovery regardless of the extent or the nature of plaintiff's loss, or of any other facts and circumstances, and regardless of whether a fiduciary relationship existed between plaintiff and the intermediate person. Many courts, so accepting label disposition, have tended thereby to view the standing-to-sue requirement in general terms and thus have denied all plaintiffs who fall into certain classes of persons—lessors, landlords, stockholders, corporate officers, creditors, suppliers, franchisors, licensors—antitrust protection by holding that when the business and property interests of such plaintiffs are injured because of injuries to the competitive market of persons with whom they are related or connected the plaintiffs' position vis-a-vis the offending defendants is 'indirect.' . . . [I]t seems to me that perhaps the use by courts in antitrust opinions of inherited decisional labels may have obfuscated the positions of some plaintiffs so as to have denied them the recoveries which fact-analysis might have indicated they should have obtained."[5]

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5. The plaintiff in *Billy Baxter* has already filed a petition for a writ of certiorari.

B. The Standing Test Adopted by the Court Below Is More Restrictive Than the Standing Test Sanctioned by This Court in Its Recent Decisions.

In three recent decisions, this Court has conferred standing on private plaintiffs challenging administrative regulations where such regulations have caused them injury and where they have been within the zone of interests embraced by the regulations in question. *Arnold Tours, Inc. v. Camp*, — U. S. — (1970); *Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U. S. 150 (1970); *Barlow v. Collins*, 397 U. S. 159 (1970). In light of these three decisions, the Third Circuit's attempt to distinguish between standing and stating a cause of action is patently erroneous (Appendix, p. A17). If the Third Circuit had limited its concern to traditional notions of standing, petitioner's standing to sue would be beyond contest since defendants' actions have caused him injury and since petitioner is within the zone of interests encompassed by the statutes in question.

Indeed, the Investment Company Institute, the trade association representative for the mutual fund industry and a defendant herein, recently filed a reply brief in *Investment Company Institute v. Camp*, Oct. Term, 1970, No. 61, in which it argued:

> "This Court has, in a consistent course of recent decisions, liberalized the doctrine of standing, which had previously been applied to bar injured persons from challenging allegedly illegal governmental actions. [Cases cited.] These decisions reflect the 'trend . . . toward enlargement of the class of people who may protest administrative action.' [Case cited.] Recently, this Court expressly discarded the 'legal interest' test as a condition of standing . . ." Securities Regulation & Law Report, No. 78, Nov. 25, 1970, p. F-9.

Nonetheless, in the case at bar, defendants and the Court of Appeals have restricted the class of injured persons who may challenge antitrust violations.

Thus, this Court should grant this petition in order to remedy the incongruous situation in which standing under the antitrust laws is more narrowly conferred than under recent decisions of this Court permitting private challenges to administrative regulation by governmental agencies.

C. The Decision Below Vitiates the Congressional Concern Underlying the Investment Company Act of 1940.

In the Investment Company Act of 1940, 15 U. S. C. §§ 80a-1 *et seq.*, Congress has clearly indicated that its primary concern was to protect investors in investment companies, that is, mutual fund customer-shareholders. Indeed, in Section 1, "Findings and Declaration of Policy," Congress stated that "the national public interest and the *interest of investors* are adversely affected" (15 U. S. C. § 80a-1(b)) (emphasis supplied):

> "(2) When *investment companies are organized, operated, managed,* or their portfolio securities are selected, *in the interest of directors, officers, investment advisers,* depositors, or other affiliated persons thereof, . . . or *in the interest of other investment companies* . . . rather than in the interest of all classes of such companies' security holders [*i.e.*, their customer-shareholders]." (Emphasis supplied.)

In sum, Congress declared that its "policy and purposes" were "to mitigate and, so far as is feasible, to eliminate the conditions enumerated in [Section 1] which adversely affect the national public interest and the *interest of investors.*" 15 U. S. C. § 80a-1(b). (Emphasis supplied.)

Thus, Congress concluded that the customer-shareholders of mutual funds, *i.e.*, investors in investment com-

panies, are the *primary victims* of mismanagement of mutual fund assets. Several courts have affirmed this congressional conclusion. See, *e.g.*, *Brown v. Bullock*, 194 F. Supp. 207, 245 (S. D. N. Y. 1961) *aff'd* 294 F. 2d 415 (2d Cir. 1961) (*en banc*); *Greater Iowa Corp. v. McLendon*, 378 F. 2d 783, 793-794 (8th Cir. 1967). Most recently, the Fifth Circuit in *Herpich v. Wallace*, 430 F. 2d 792, 816 (1970) stated:

> "From a reading of the 'Findings and Declarations of Policy' in section 1, as well as of the substantive provisions of the Act, we think it is clear in light of the circumstances under which the Act was passed that Congress intended to provide a comprehensive regulatory scheme to correct and prevent *certain abusive practices in the management of investment companies for the protection of persons who put up money to be invested by such companies on their behalf.*" (Emphasis supplied.)

With the specific congressional concern for the interests of customer-shareholders of mutual funds provided by the Investment Company Act of 1940, outmoded concepts of corporate law must not be woodenly invoked to deny standing to mutual fund customer-shareholders who have had *their assets* reduced because of defendants' violation of the antitrust laws in fixing grossly excessive management fees.

Accordingly, Courts of Appeals have held that mutual fund customer-shareholders have claims *in their own right* for violations of the Investment Company Act of 1940. *Herpich v. Wallace, supra; Esplin v. Hirschi*, 402 F. 2d 94, 103 (10th Cir. 1968) *cert. denied* 394 U. S. 928 (1969); *Brown v. Bullock*, 194 F. Supp. at 229-233. There is no rational basis for depriving the very same customer-shareholders of standing to sue *in their own right* merely because their

claims arise under the antitrust laws, particularly when their claims involve the very same subject matter which motivated the congressional concern reflected by the Investment Company Act of 1940.

Furthermore, from its inception, the mutual fund industry, unlike any other, has been characterized by an absence of competition in the fixing of management fees. As Hamer H. Budge, Chairman of the SEC, has stated:

> "This pattern is commonly referred to as one of external management. It is the traditional way of doing things in the investment company field, but it is hard to conceive of anything like it anywhere else . . . Mutual funds just do not go out to buy advisory . . . services on the open market on the best terms they can get. They are generally tied to their advisers. *The adviser sets his price and, typically, the fund pays that price. The arm's-length bargaining element in the ordinary business relationship is completely lacking here.*
> "The structural arrangements found in this industry create an economic environment in which *normal market restraints on managerial compensation are conspicuous by their absence.* This is a situation in which insiders usually bargain with themselves. *In this type of system, legal controls are needed in order to do what normal market forces can be depended on to do elsewhere.*
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> ". . . whatever competition there has been in the industry has historically been for sales, and recently for performance, *but never for lower advisory fees . . .*" *Hearings*, Mutual Fund Legislation of 1969, Part 2 at pp. 855, 858. (Emphasis supplied.)

If the decision of the Third Circuit were permitted to stand, the entire mutual fund industry would be permitted

to continue without competition and the congressional concern underlying the enactment of the Investment Company Act of 1940, 15 U. S. C. §§ 80a-1 *et seq.*, would be vitiated.

D. This Petition Raises Important Questions Regarding the Scope of This Court's Decision in Ross v. Bernhard, 396 U. S. 531 (1970) and Regarding Rule 23 of the Federal Rules of Civil Procedure.

In *Ross v. Bernhard*, 396 U. S. 531, 540 (1970), this Court held that "it is no longer tenable for a district court . . . to deny legal remedies to a corporation, merely because the corporation's spokesmen are its shareholders rather than its directors." In *Ross*, this Court made it crystal clear that in a derivative suit, "[t]he claim pressed by the stockholder against directors or third parties 'is not his own, but the corporation's'. . . . The heart of the action is the corporate claim." 396 U. S. at 538-539.[6] Thus, it was erroneous for the Third Circuit to hold that a mutual fund customer-shareholder could not enforce the right of his four funds to commence a class action on behalf of all other mutual funds similarly situated, particularly after it was conceded that "if the fund itself sought to bring a class action on behalf of other funds similarly situated, there would be no theoretical barrier prohibiting such a class action." Appendix, p. A24.[7]

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6. Nevertheless, in rejecting petitioner's attempt to enforce the right of his four funds to bring this action on behalf of all other mutual funds similarly situated, the Third Circuit stated that "[a] shareholder can only require a corporation to initiate a matter to protect the rights of a shareholder *qua* shareholder." Appendix A, p. A24.

7. All mutual funds which comprise the class are dominated and controlled by their investment advisers and self-dealing directors and, therefore, are devoid of volition to correct the abuses prevailing in the mutual fund industry.

In sum, pursuant to this Court's decision in *Ross v. Bernhard, supra:* (1) a shareholder suing on behalf of a corporation may bring all suits which a corporation could commence but for the refusal of its officers and directors; (2) a corporation could commence a class action on behalf of all other corporations similarly situated; and, therefore (3) a shareholder may enforce the rights of his corporation to commence a class action on behalf of all other corporations similarly situated.

Finally, contrary to the decision of the Third Circuit, Appendix, p. A22, Rules 23 and 23.1 are not mutually exclusive. As recognized by this Court, derivative stockholders' actions have always been considered analogous to "true" class actions. *Ross v. Bernhard*, 396 U. S. at 541; 2 *W. Barron & A. Holtzoff, Federal Practice and Procedure* § 562.1 (Wright ed. 1961).

Furthermore, both Rule 23 and Rule 23.1 have always been liberally applied in order to avoid multiplicity of suits and to provide compensatory or injunctive relief to large numbers of claimants. See, *e.g., Kahan v. Rosenstiel*, 424 F. 2d 161, 169 (3d Cir. 1970) *cert. denied* — U. S. — (1970); *Green v. Wolf Corp.*, 406 F. 2d 291, 298-298 (2d Cir. 1968) *cert. denied* 395 U. S. 977 (1969); *Eisen v. Carlisle & Jacquelin*, 391 F. 2d 555, 560-563 (2d Cir. 1968). As the Court stated in *Eisen*, an action commenced under Section 4 of the Clayton Act for violations of Sections 1 and 2 of the Sherman Act (391 F. 2d at 560):

> "Class actions serve an important function in our judicial system. By establishing a technique whereby the claims of many individuals can be resolved at the same time, the class suit both eliminates the possibility of repetitious litigation and provides small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation."

The importance of the private suit in the enforcement of the vital national policies underlying the antitrust laws is further enhanced when such suits are brought as class actions, for, as the court recognized in *Illinois v. Harper & Row Publishers, Inc.*, 301 F. Supp. 484, 493-494 (N. D. Ill. 1969), "[u]pholding the national class action will facilitate private antitrust litigation and will discourage future conspiracy violations."

In addition, discouragement of class actions can only lead to inefficient judicial administration. Indeed, "[t]he very purpose to be served by a class action is the opportunity it affords **to prevent a multiplicity of suits based on a wrong common to all** . . ." *Green v. Wolf Corp.*, 406 F. 2d at 300. (Boldface supplied.) As the Court stated in *Green* (406 F. 2d at 301):

> ". . . If a class action is markedly superior to all the alternatives, then, at least at the early stages of the litigation, we should *construe broadly* the other elements of Rule 23, to permit the efficient enforcement of 10b-5 [here the antitrust laws] through class actions with appropriate safeguards . . .
>
> ". . . We recognize that this might, in cases such as this, place additional burdens on judges but the *alternatives are either no recourse for thousands of stockholders to whom the courthouse would thus be out of bounds or a multiplicity and scattering of suits with the inefficient administration of litigation which follows in its wake.*" (Emphasis supplied.)

The avoidance of a multiplicity of actions and the concentration of litigation in one forum referred to in *Green, supra*, is not an abstraction:

> "The history of the schoolbook conspiracy cases . . . shows that after one court ruled that a class action was

> not proper . . . such a plethora of suits were filed all over the country that the machinery of the Panel on Multi-District Litigation had to be called upon to disentangle the jumble." *Research Corp. v. Pfister Associated Growers, Inc.*, 301 F. Supp. 497, 503 (N. D. Ill. 1969).

The same multiplicity of suits will follow herein unless the decision of the Court of Appeals is overturned.

Accordingly, the decision of the Court of Appeals will deter effective enforcement of the antitrust laws by private parties and will promote inefficient judicial administration by compelling the filing of a multiplicity of suits throughout the country. The Multidistrict Litigation Panel then will be required to unravel the morass of litigation by consolidating all of the actions in one forum, which was precisely petitioner's objective herein. See the Multidistrict Litigation Act, 28 U. S. C. § 1407.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that this Court should grant the Petition for a Writ of Certiorari to review the judgment of the Court of Appeals for the Third Circuit.

Respectfully submitted,

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CERTIFICATE OF SERVICE.

I hereby certify that on this 22nd day of December, 1970, three copies of the Petition for a Writ of Certiorari were served, by first class mail, postage prepaid, on each of the following attorneys:

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I further certify that all parties required to be served have been served.

/s/ Bruce W. Kauffman,
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APPENDIX.

Order of the United States District Court for the District of New Jersey Filed on October 1, 1969.

WHEREAS, defendants moved to dismiss the complaint on the grounds that (1) plaintiff is not an adequate representative of the mutual investment funds which he purports to represent pursuant to *Rules* 23 and 23.1, *F. R. Civ. P.*; (2) plaintiff cannot maintain this action on behalf of individual shareholders as his claim for damages is a derivative action and any recovery would be solely for the benefit of the named mutual investment funds; (3) Counts I, II and III should be dismissed as they seek relief by the plaintiff on behalf of mutual investment funds of which he is not a shareholder and on behalf of shareholders of funds of which he is not a common shareholder; and (4) to dismiss Counts II and III of the complaint, except to the extent that plaintiff is a shareholder of certain named defendants, on the grounds that any duties imposed by the *Investment Company Act of 1940*, 15 *U. S. C.* §§ 80a-1 *et seq.*, are legal obligations owed only to mutual investment fund advisers and directors for the benefit of shareholders of such funds and not to strangers to such mutual investment funds; and

WHEREAS, upon these four motions defendants have not carried the required burden of proof for the dismissal of the complaint, or certain counts thereof, particularly when terminal relief is sought pending pretrial discovery in this complex, anti-trust litigation;

Now, Therefore, it is on this 30th day of September, 1969 Ordered that the above enumerated four motions for the dismissal of the complaint, or certain counts thereof, be and the same are denied hereby without prejudice to their renewal at an appropriate time later in these proceedings.

Mitchell H. Cohen,
Mitchell H. Cohen, *Judge*,
United States District Court.

Memorandum Opinion of the United States District Court for the District of New Jersey Filed on December 18, 1969.

COHEN, *District Judge:*

This is a motion by certain of numerous defendants, supported and resisted by briefs and arguments, upon rehearing, *General Rule* 12-I, *U. S. D. C. N. J.*, urging a reconsideration of this Court's Order filed October 1, 1969 which denied their four motions to dismiss the complaint as to them; alternatively, defendants petition for certification pursuant to 28 *U. S. C.* § 1292(b).

The complaint is stated in three counts. In Count I, brought under the *Sherman and Clayton Acts*, 15 *U. S. C.* § 1, *et seq.*, plaintiff seeks the following relief: (a) treble damages for himself, (b) for each member of a class which he purports to represent, (c) for each of the defendant externally managed mutual funds, (d) for each member of the class mentioned in (c), (e) a final injunction restraining the defendants from paying or receiving grossly excessive management fees, and (f) costs and counsel fees; in Count II, brought under the *Investment Company Act of 1940*, 15 *U. S. C.* § 80a-1 *et seq.*, he seeks the same treble damages and equitable relief for himself and others as in Count I; and in Count III, brought under the *Securities Exchange Act of 1934*, 15 *U. S. C.* §§ 78a *et seq.*, the *Investment Advisors Act of 1940*, 15 *U. S. C.* §§ 80b-1 *et seq.* and under the *Investment Company Act of 1940*, 15 *U. S. C.* §§ 80a-20, 80a-33, he demands such damages as are determined to have been sustained by him and the classes which he purports to represent. In essence, the plaintiff maintains that the defendant management and investment advisors, be they corporate or individual, as well as the alleged "self-dealing" directors of the externally managed mutual funds, conspired to fix grossly excessive fees, thereby illegally monop-

olizing the mutual funds investment market, all to his damage, and to that of the classes, both mutual and shareholder, which he purports to represent.

The four motions[1] which were reargued and reconsidered were those challenging the legal standing and capacity of the plaintiff to maintain his complaint which is based upon alleged violations of the *Antitrust* and *Securities Laws* of the United States and upon conspiracies to violate the same. In support of their motions, the defendants urged the following: (1) that inasmuch as the plaintiff is a shareholder in *only four* of the defendant mutual funds,[2] he does not fairly and adequately represent the interests of all other funds or their shareholders as required by *Rules* 23 and 23.1, *F. R. Civ. P.*; (2) he cannot individually or representatively assert claims on behalf of individual shareholders of mutual funds, as such claims are necessarily *derivative* in nature and thus for the benefit of the corporations alone, *Rule* 12(b)(6), *F. R. Civ. P.*; (3) he cannot maintain this action to the extent that it seeks relief in Counts I, II and III of the complaint, (a) on behalf of mutual funds of which he is not a shareholder, (b) on behalf of shareholders of said funds of which he is not a shareholder because one may not maintain a legal action on behalf of a corporation or its shareholders, unless he is a shareholder of such corporation, *Rules* 12(b)(6), 23 and 23.1, *F. R. Civ. P.*, and (4) Counts II and III of the complaint fail to state claims upon which relief can be granted in that the conspiracy alleged, even if true, would not violate either the *Antitrust*, *Security Exchange* or *Investment Company Acts*.

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1. These constitute the first set of many motions filed by the defendants, the balance of which are directed to, among other matters, jurisdiction, venue and process and which were held in abeyance pending disposition of these motions.

2. Plaintiff is a shareholder in the defendants, The Dreyfus Fund, Inc., Fidelity Fund, Putnam Growth and Manhattan Funds.

In the alternative, the moving defendants petition for a permissive certification, pursuant to 28 *U. S. C.* § 1292(b), on the ground that the Order denying their motions to dismiss "involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation . . ." as to them and as well as to some 129 other defendants with whom plaintiff has no mutual shareholder relationship and which, if granted, will reduce the case to a derivative antitrust action shorn of the attempted representative class counts. Moreover, the defendants argue that a determination that this action is to proceed under the antitrust or securities laws (including the investment and advisors statutes) as a derivative one will substantially reduce the problems of jurisdiction, venue and process lurking in the other pending motions.[3]

Full and careful reconsideration has been given to the arguments advanced by able counsel upon rehearing. Nevertheless, this Court is of the conviction that nothing has been adduced which might lead to a conclusion and ruling different from its Order of October 1, 1969.[4] When

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3. The antitrust statutes distinguish between individuals (15 U. S. C. § 15), requiring personal jurisdiction by territorial process, and corporations (15 U. S. C. § 22) who may be reached with process for jurisdictional purposes if such a corporation can be "found" within the federal district forum, is an "inhabitant" thereof, or has been or is "transacting business" therein. The Securities Acts make no such distinctions. These considerations are most pertinent to some of the remaining motions and may, to a large extent, be dependent upon or resolved by the present motions.

4. The Order dated September 30th and filed October 1, 1969, contained an unfortunate choice of words when it made reference to "pretrial discovery" at this juncture of the proceedings. It was not intended to relate discovery to the four motions which were denied, but rather to certain remaining motions which may require extensive factual inquiry. To that extent it will be amended to delete that phrase.

that Order was entered denying the four motions, the Court was of the opinion, as it is now, that: (a) plaintiff does fairly and adequately represent claims on behalf of individual shareholders of the defendant mutual funds, not being limited to those of which he is himself a shareholder, nor confined to the assertion of only derivative, as distinguished from nonderivative or representative claims; that (b) this action may be maintained at least as a "hybrid class" action, a class yet to be ascertained, in order to reach and dispose of other motions involving jurisdiction, process and venue; and that (c) the conspiracy charge of the complaint directed against all investment advisors, be they corporate or individual, and against the alleged "self-dealing" directors can be maintained by the plaintiff subject, of course, to an immediate resolution of other pending motions and ultimately to a determination of whether the conduct of defendants, or any of them, violates the *Antitrust* or *Securities Acts* or both. Manifestly, in the role in which plaintiff places himself, he is in effect an "ancillary force" supplementing governmental enforcement of the *Antitrust* and *Securities Laws*. *Knuth v. Erie-Crawford Dairy Corp. Ass'n.*, 395 F. 2d 420, 423 (3 Cir. 1968). Moreover, inasmuch as the directors of the externally managed mutual funds have been charged by the plaintiff as "self-dealing," it should be inferred that in all probability they would not institute this action nor, because a charge of conspiracy has been levelled, is it likely that the shareholders could persuade their respective directors to do so on their behalf or that of their own mutuals. Several cases have upheld class actions of spurious or hybrid-class character and of national extent where the plaintiff could not claim an interest in each member of the class. *Eisen v. Carlisle & Jacquelin*, 391 F. 2d 555 (2 Cir. 1968); *Illinois v. Harper & Row Publishers, Inc.*, 1969 Trade Cases § 72,795 (N. D. Ill.

1969); *Philadelphia Electric Co. v. Anaconda Amer. Brass Co.*, 43 FRD 452 (E. D. Pa. 1968); *City of Philadelphia v. Morton Salt Co.*, 248 F. Supp. 506 (E. D. Pa. 1965).

Although the Court's prior ruling denying the defendants' motions to dismiss the complaint, or certain counts thereof, remains unchanged upon rehearing, nevertheless, it is the opinion of the Court that the said Order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal therefrom may materially advance the ultimate termination of the litigation in this complex, potentially protracted and probable multi-district antitrust and securities action, thereby avoiding great expenditures of time and money for pretrial procedures. These motions do go to the merits of the litigation in the sense that they strike at plaintiff's legal capacity to sue certain defendants in the very first instance. Further, whether or not these large mutual funds should be put to the prohibitive expense of defense, when the plaintiff's status to maintain such an action against certain of them is challenged as a matter of law, is an issue which should receive early resolution. In these circumstances, one is mindful of Judge Maris' admonition in 1958, expressed in *Milbert v. Bison Laboratories*, 260 F. 2d 431 at page 433, when *Section* 1292(b) of *Title* 28, *United States Code*, was but two months old:

> ". . . Congress intended that section 1292(b) should be sparingly applied. It is to be used only in exceptional cases where an intermediate appeal may avoid protracted and expensive litigation and is not intended to open the floodgates to a vast number of appeals from interlocutory orders in ordinary litigation. Both the district judge and the court of appeals are to exercise independent judgment in each case and are not to act routinely."

See also: *Freedman v. Phila. Terminals Auction Co.*, 197 F. Supp. 849 (E. D. Pa. 1961), aff'd 301 F. 2d 830 (3 Cir. 1962), *cert. den.* 371 U. S. 829 (1962); *King v. Grand Lodge of Inter'l. Ass'n. of Machinists*, 215 F. Supp. 351, 355 (N. D. Cal. 1963); aff'd 335 F. 2d 340 (9 Cir 1964), *cert. den.* 379 U. S. 920 (1964), where the denial of a motion for summary judgment which challenged the plaintiffs' rights to sue, as a matter of legal capacity, for alleged improper discharges from union offices was held to be properly certified because it involved a controlling question of their rights to relief on three of six causes of action.

The instant case is not an ordinary one—it is, rather, one of great dimension involving, as it does, some 141 defendants and makes an attack nationwide upon the entire mutual fund industry and demands damages in many millions of dollars. Consequently, and particularly in a case of this magnitude, the possibility of judicial error warrants the grant of a certificate for interlocutory appeal in the interest of avoiding needless and large expenditures of time and money by these defendants and, perhaps more importantly, the adverse exposure of their reputations and public images in today's hyper-sensitive financial markets. In such an event, if there be error, it seems better by far for a trial court to err upon the side of procedural liberality rather than succumb to considerations of rigid conservatism. In these circumstances, certification of appeal seems most appropriate at this critical juncture and well within the sphere of interlocutory appeal provided by Congress for extraordinary litigation.

Accordingly, an order so certified shall be granted and is entered herewith.

MITCHELL H. COHEN,
Mitchell H. Cohen, *Judge,*
United States District Court.

Order of the United States District Court for the District of New Jersey Dated December 18, 1969.

This matter having been brought on by counsel for defendants for reconsideration of motions denied by Order filed October 1, 1969, and reargument having been made by opposing counsel; and

The Court being satisfied that nothing has been adduced which should lead it to a different ruling, except that the phrase in the prior Order reading "pending pretrial discovery" should be deleted;

Now, therefore, it is on this 18th day of December, 1969, upon reconsideration, ORDERED that the defendants' motion for a redetermination of this Court's prior order filed October 1, 1969 is denied hereby; and

It is further ORDERED that the phrase "pending pretrial discovery" in the said Order be deleted and deemed amended to that extent only; and further

It is certified that, in the opinion of the Court, the ruling on said motions involves a controlling question of law as to which there is substantial ground for a difference of opinion and that an immediate appeal may materially advance the ultimate disposition of this protracted, complex, expensive and extraordinary litigation with respect to many, if not most, of the parties-defendant hereto; and consonant therewith,

It is further ORDERED that all proceedings in this Court be stayed until further order by the United States Court of Appeals for the Third Circuit, or this Court.

MITCHELL H. COHEN,
Mitchell H. Cohen, *Judge*,
United States District Court.

Order of the United States Court of Appeals for the Third Circuit Dated January 22, 1970.

Present: FORMAN and SEITZ, *Circuit Judges.*

Upon consideration of petitioner's application in each of the above-entitled cases, for permission to appeal pursuant to the provisions of 28 U. S. C. Section 1292(b), and the answer in opposition thereto,

It is ORDERED that leave be, and hereby is granted to petitioner to appeal from the interlocutory order of the District Court for the District of New Jersey, entered October 1, 1969, and the interlocutory order of the said District Court, filed December 18, 1969, which order affirmed and modified the said order filed October 1, 1969, all in the case of Joseph B. Kauffman, etc. v. The Dreyfus Fund, Inc. et al., Civil No. 1348-68. / See the provisions of Rule 5(d), Federal Rules of Appellate Procedure.

By the Court,

PHILLIP FORMAN,
Circuit Judge.

Dated: January 22, 1970

Order of the United States Court of Appeals for the Third Circuit Dated April 10, 1970.

Present: SEITZ and ALDISERT, *Circuit Judges*, and LATCHUM, *District Judge*.

Upon consideration of appellee's motion to expedite appeals, and appellants' response in opposition thereto, and appellants' cross-motion for extension of time to file brief, and appellee's response in opposition thereto, all in the above-entitled cases, and it appearing that appellants have elected to proceed under the provision of Rule 30(c), F. R. A. P.,

It is ORDERED that the following briefing schedule be followed by appellants and appellee:

1) Appellants' preliminary brief(s), original and three copies, in either xerox or pageproof form, be filed and served not later than April 20, 1970;

2) Appellee's preliminary brief(s), original and three copies in either xerox or pageproof form, be filed and served not later than May 11, 1970;

3) Appellants' reply brief(s), if any, in either preliminary or final form, be filed and served not later than May 25, 1970;

4) The appendix to be filed and served not later than May 25, 1970;

5) Brief in final form to be hand-filed and hand-served not later than June 5, 1970; and

It is Further ORDERED that the Clerk of this Court list this case for argument on the merits during the week of June 22, 1970; and

It is Further Ordered that counsel for appellants and counsel for appellee advise the Clerk of this Court by letter, at the time of filing their respective preliminary brief, as to the total amount of argument time beyond thirty minutes, if any, which each side will request, and the number of counsel who will wish to argue for each side.

By the Court,

Seitz,

Circuit Judge.

Dated: April 10, 1970

Opinion of the United States Court of Appeals for the Third Circuit Filed on September 24, 1970.

ALDISERT, *Circuit Judge*.

Before us for review is an interlocutory order of the district court, duly certified for appeal under the provisions of 28 U. S. C. § 1292(b), denying appellants' motions to dismiss the action in its entirety or, alternatively, to dismiss certain individual, representative, and derivative claims.

Plaintiff-appellee, a shareholder of four mutual funds,[1] filed a three-count action against 65 mutual funds, 38 investment advisers, 37 directors alleged to be serving contemporaneously as fund directors or trustees and investment advisers, and the Investment Company Institute, a trade association. Appellee also sued a number of unnamed defendants as part of the three defendant classes: mutual funds, investment advisers, and "self-dealing" directors.

Charging violations of the Sherman Act, 15 U. S. C. §§ 1, 2, and the Clayton Act, 15 U. S. C. §§ 15, 26, Count I alleges that appellants have engaged in a combination and conspiracy "with horizontal and vertical forms and levels of agreement," to adopt and stabilize fees for management services and investment services, to limit competition, to refrain from providing internal fund management, and to otherwise monopolize the management market.

Count II invokes provisions of the Investment Company Act of 1940, 15 U. S. C. §§ 80a-1, *et seq.* It asserts that the investment advisers indulge in practices known as "give-ups," whereby they direct brokers to execute stock transactions for less than the commission paid to them, giving up the balance to non-executing brokers, and "reciprocals," whereby the advisers, in return for allocating por-

1. The Dreyfus Fund, Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc., and The Putnam Growth Fund.

tions of the commissions to non-executing brokers, receive additional compensation in the form of free or discounted investment advice and management services.

Count III, brought under the Securities Exchange Act of 1934, 15 U. S. C. § 78n, the Investment Advisers Act of 1940, 15 U. S. C. §§ 80b-6, and the Investment Company Act, *supra*, charges appellants with misrepresentation in the preparation and issuance of proxy and other statements, including the failure to disclose, or the making of false disclosures with respect to, the alleged wrongdoing set forth in Counts I and II.

Appellee sought to maintain this action in several capacities: as a shareholder in his own right against the four funds in which he holds stock; as a class representative under FED. R. CIV. PRO. 23 of all similarly situated shareholders of 65 mutual funds; by virtue of his class representation of all similarly situated shareholders, derivatively on behalf of 65 mutual funds similarly situated; derivatively, under FED. R. CIV. PRO. 23.1, on behalf of the four funds of which he is a shareholder; and derivatively on behalf of the four mutual funds as a class action on behalf of the 61 other funds similarly situated.

The district court overruled the challenges to appellee's right to bring the action in any or all of the above capacities. This appeal followed, presenting for our consideration the following issues:

A. Does a shareholder of a mutual fund have a primary or personal cause of action to recover damages allegedly sustained by his corporation by reason of violations of the antitrust and security laws?

1. If so, may he sue as a class representative under Rule 23 on behalf of all similarly situated shareholders of other mutual funds?

2. And if he may sue on behalf of these shareholders, may he thereby acquire standing to sue secondarily or derivatively on behalf of the 65 mutual funds?

B. Does a shareholder of mutual funds who sues derivatively on behalf of those funds have standing to bring a class derivative action on behalf of other funds similarly situated?

C. Is a conflict of interest or disabling antagonism presented by appellee's suit on behalf of mutual funds against which he is simultaneously seeking an adjudication of liability?

A

A stockholder of a corporation does not acquire standing to maintain an action in his own right, as a shareholder, when the alleged injury is inflicted upon the corporation and the only injury to the shareholder is the indirect harm which consists in the diminution in value of his corporate shares resulting from the impairment of corporate assets. In this situation, it has been consistently held that the primary wrong is to the corporate body and, accordingly, that the shareholder, experiencing no direct harm, possesses no primary right to sue. *Ash v. International Business Machines*, 353 F. 2d 491 (3 Cir. 1965), *cert. denied*, 384 U. S. 927 (1966); *Loeb v. Eastman Kodak Co.*, 183 Fed. 704 (3 Cir. 1910).

Conceding the basic vitality of this rule, appellee contends that the mutual fund is a novel corporate structure and that the unique relationship of the shareholder to the corporation confers upon the shareholder a primary right to redress harm to the fund. Since the redemptive value of a mutual fund share bears a direct relationship to the total net assets owned by the fund, the redemptive value is always directly affected by the net value of the total assets. Therefore, it is argued, when an injury to the

fund threatens the value of the assets, the shareholder possesses a primary right to sue.

The difficulty we perceive in this approach is that it fails properly to appreciate, or seeks to ignore, the fundamental tenet of corporation law which treats the corporate body as an entity—indeed, as a person—separate and distinct from those who own shares of its stock. It is this concept of separate identities which is the basis for distinguishing the rights, responsibilities, and immunities of shareholders from the rights and obligations of the corporation. It is this concept that reserves for the corporation the right to vindicate wrongs which harm the corporation, injuring the shareholders only in the sense that stock values are imperiled.

That the worth of a share of appellee's stock is directly proportionate to the value of a mutual fund's net assets is insufficient to destroy these separate identities, to alter the basic shareholder-corporation relationship, and to thereby confer upon appellee legal rights peculiar to the corporation. Nowhere in the cases do we find authority for the proposition that the ease and capacity of evaluating a shareholder's redemptive value of mutual fund shares can vest in him a pro-rata share of the corporation's primary right to sue. To accept this would be to convert an orthodox corporate structure to a general partnership or joint venture with each participant a principal and agent for the others.

Appellee further argues, however, that his right to sue is established by the antitrust character of this action. He insists that he need not be "directly" injured in order to maintain private treble damage claims, since "the word 'direct' does not appear in Section 4 of the Clayton Act," and because "[a]ll the law requires to state a private treble damage action claim are allegations adequate to show a violation of the antitrust acts and plaintiff has been dam-

aged thereby." *Knuth v. Erie-Crawford Dairy Coop. Ass'n.*, 395 F. 2d 420, 423 (3 Cir. 1968).

We have no quarrel with the view that such allegations are sufficient to state a claim. But we must not confuse requirements necessary to state a cause of action, which is not in issue here, with the prerequisites of standing. Our inquiry here concerns the issue of appellee's standing to sue in his own right when the injury alleged is the reduction in value of corporate shares. This court has considered this precise issue before and has rejected the position pressed by appellee. In *Ash, supra*, 353 F. 2d at 493-94, Chief Judge Hastie stated:

> [T]he complaint discloses that the hurtful effect of [the corporation's] conduct upon the value of his stock in competing corporations is the only injury he claims to have suffered.
>
> Such harm is not enough to make the plaintiff a "person . . . injured in his business or property" within the meaning of section 4 of the Clayton Act. The courts have consistently ruled that this language does not include the indirect harm that an individual may suffer as a stockholder through injury inflicted upon a corporation [Citations omitted].
>
> Indeed, were the rule otherwise the distinction between a stockholder's derivative claim and a claim exercised in his primary right would disappear, and the public policy based strictures on derivative suits could be avoided merely by asserting that economic harm to a corporation in itself constituted justiciable personal injury to each owner of stock in the corporation.

It being established that appellee's alleged injury is by definition "indirect," his attempt to prosecute this action

in his own right, as a shareholder, cannot succeed. Efforts to characterize the harm as "direct," or, arguments that "proximate harm" is sufficient or that appellee is "within the sector of the economy in which the violation threatened a breakdown of competitive conditions," *South Carolina Council of Milk Products, Inc. v. Newton*, 360 F. 2d 414, 418 (4 Cir.), *cert. denied*, 385 U. S. 934 (1966), are simply unavailing in light of *Ash*. Indeed, appellee has cited no case in which a shareholder has achieved standing to remedy the type of harm portrayed here.

Because appellee, as a shareholder of the four funds, does not have standing to assert a personal action, it is evident that he may not serve as a class representative under Rule 23 on behalf of all similarly situated shareholders of the 65 funds. Before one may successfully institute a class action "[i]t is of course necessary generally that [he] be able to show injury to himself in order to entitle him to seek judicial relief." *Kansas City, Mo. v. Williams*, 205 F. 2d 47, 51 (8 Cir.), *cert. denied*, 346 U. S. 826 (1953). A plaintiff who is unable to secure standing for himself is certainly not in a position to "fairly insure the adequate representation" of those alleged to be similarly situated. *See* Wright, *Law of Federal Courts* 307-08. In short, a predicate to appellee's right to represent a class is his eligibility to sue in his own right. What he may not achieve himself, he may not accomplish as a representative of a class.

We must also reject the attempt to convert a shareholder class action, based on the theory of a personal primary right, to a class derivative action—through the shareholders—on behalf of the mutual funds. As noted, appellee is foreclosed from pursuing an action in his own right and, accordingly, may not create a class suit bottomed on such an action. Manifestly, what he may not create, he can-

not convert. The attempt, while resourceful, is congenitally incompatible.

B

We turn now to an examination of the contention that a shareholder of mutual funds who sues derivatively on behalf of those funds has standing to bring a class derivative action on behalf of other funds similarly situated.

Initially, we recognize that a shareholder of a corporation has standing to maintain a derivative action to enforce rights of that corporation. Rule 23.1. To be sure, "the most common example of [a derivative] action is a suit by minority stockholders . . . who claim that the corporation has been wronged." Wright, *supra*, at 317. Accordingly, putting aside the question of a possible conflict of interest, there is no doubt that appellee may litigate derivative actions in behalf of the four funds in which he holds shares. It is, of course, immaterial that these corporations have been named as defendants in the pleadings. Indeed, the shareholder's corporation must be made a separate party defendant, or the suit would be dismissed for failure to include an indispensable party, *Sylvia Martin Foundation, Inc. v. Swearingen*, 260 F. Supp. 231 (S. D. N. Y. 1966); *Philipbar v. Derby*, 85 F. 2d 27 (2 Cir. 1936); and the shareholder's corporation is entitled to answer the shareholder's complaint and defend its refusal to sue. *Otis & Co. v. Pennsylvania R. Co.*, 57 F. Supp. 680 (E. D. Pa. 1944). As Mr. Justice Frankfurter observed in his classic dissent in *Smith v. Sperling*, 354 U. S. 91, 99 (1957):

> The contrasting difference between a stockholder's suit for his corporation and a suit by him against it, is crucial. In the former, he has no claim of his own; he merely has a personal controversy with his corporation regarding the business wisdom or legal basis for the latter's assertion of a claim against third parties.

> Whatever money or property is to be recovered would go to the corporation, not a fraction of it to the stockholder. When such a suit is entertained, the stockholder is in effect allowed to conscript the corporation as a complainant on a claim that the corporation, in the exercise of what it asserts to be its uncoerced discretion, is unwilling to initiate. This is a wholly different situation from that which arises when the corporation is charged with invasion of the stockholder's independent right. Thus, for instance, if a corporation rearranges the relationship of different classes of security holders to the detriment of one class, a stockholder in the disadvantaged class may proceed against the corporation as a defendant to protect his own legal interest.

Appellee would have us further hold, however, that he is also entitled to bring a class derivative action on behalf of the 61 mutual funds in which he owns no shares but which are said to be similarly situated. It is his position that Rule 23.1 (stockholder derivative actions) and Rule 23 (class actions) should be read together to permit such a suit. We are of the opinion that this position is untenable.

Rule 23.1 specifically provides:

> In a derivative action brought by one or more shareholders . . . to enforce a right of a corporation . . . the complaint . . . shall allege (1) that the plaintiff was a shareholder . . . at the time of the transaction of which he complains or that his share . . . thereafter devolved on him by operation of law. . . .

It is uncontroverted that appellee is not now nor ever was a stockholder of any of the 61 funds he wishes to represent as a class representative in his derivative action. Thus, he

has not complied with this provision's unambiguous requirement—amounting to a legal principle—that one who does not own shares in a corporation is not qualified to bring a derivative action in his behalf.[2]

The timber of sound reason forms the conceptual underpinning of the rule requiring stock ownership in a corporation as the prerequisite for bringing a derivative action in its behalf. Only by virtue of the shareholder's interest, which has been described as "a proprietary interest in the corporate enterprise which is subject to injury through breaches of trust or duty on the part of the directors," *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, 321 (1936), does equity permit him "to step into the corporation shoes and seek in its right the restitution he could not demand in his own."[3] Standing is justified only by this proprietary interest created by the stockholder relationship and the possible indirect benefits the nominal

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2. *Lawrence v. Baltimore Paint & Chemical Corp.*, 298 F. Supp. 373 (D. Md. 1969). *See also* Wright, *supra*, at 318-19.

3. *Cohen v. Beneficial Loan Corp.*, 337 U. S. 541, 548 (1949). Mr. Justice Jackson further observed:

> He sues, not for himself alone, but as a representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity. And while the stockholders have chosen the corporate director or manager, they have no such election as to the plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the state to place its litigating and adjudicating processes at the disposal of such a representative, at least without imposing standards of responsibility, liability and accountability which it considers will protect the interest he elects himself to represent. It is not without significance that this court has found it necessary long ago in the equity rules [old Equity Rule 94, 104 U. S. ix; Equity Rule 27, 226 U. S. 649, 656] and now in the Federal Rules of Civil Procedure [former Rule 23(b), now Rule 23.1] to impose procedural regulations of the class action not applicable to any other.

Id. at 549-50.

plaintiff may acquire *qua* stockholder of the corporation which is the real party in interest. Without this relationship, there can be no standing, "no right in himself to prosecute this suit," *Hawes v. Oakland* (Hawes v. Contra Costa Water Co.), 104 U. S. 450, 462; *Venner v. Great Northern Railway*, 209 U. S. 24, 34 (1908).

Moreover, because it appears that Rule 23.1 was enacted for the purpose of treating stockholder derivative actions independently of Rule 23, we are particularly unwilling to permit appellee to combine the provisions of these two rules. As Professor Wright has pointed out:

> [I]n almost all derivative actions the stockholder is suing on behalf of a large class of other minority stockholders similarly situated. Because of this in the original rules these actions were treated in Rule 23(b), as a part of class actions generally. *In the 1966 revision it was decided to deal independently with derivative actions by stockholders in a separate Rule 23.1. Thus the general class action rule, Rule 23, no longer applies to stockholders' derivative suits.* By the same token, suits by stockholders that are not derivative, . . . are not subject to Rule 23.1.

Wright, *supra*, at 318-19 (emphasis supplied).[4]

Putting aside the enactment of Rule 23.1 as a separate rule, there is a serious question whether, in any case, the explicit limitation provisions have the capacity of expansion by the superimposition of the language of Rule 23

4. "'Derivative' actions on behalf of corporations do not fit in the groove of class actions. First, they do not necessarily involve a numerous class of shareholders. *Cf.* Galdi v. Jones, 141 F. 2d 984, 992 & n.3b (2 Cir. 1944). Second, they require special provisions regarding preconditions of suit such as demands on the corporation to bring the action." Kaplan, "Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)," 81 HARV. L. REV. 356, 387, n.118.

permitting class actions when "there are questions of law or fact common to the class." Such questions cannot be common to the class when one who purports to be the class representative does not, in fact, own shares in a corporation whose interest he seeks to represent. The rights sought to be enforced cannot be considered "common" to those who do and those who do not own shares. "[T]he parties before the court must be members of the class they seek to represent. See *e.g. Hansberry v. Lee*, 311 U. S. 32, 61 S. Ct. 115, 85 L. Ed. 22 (1940); 3A MOORE, FEDERAL PRACTICE ¶ 23.04 at p. 3419." *Dolgow v. Anderson*, 43 F. R. D. 472, 491 (1968).

Accordingly, the attempt to bring a class action in behalf of all funds, by virtue of appellee's entitlement to bring derivative suits in behalf of each of the funds in which he holds shares, must fall.[5]

It is also necessary to consider appellee's alternative theory supporting his attempt to "commence a class action on behalf of all corporations." This concept seeks to achieve the same result as the class derivative action we have just discussed, but it is rationalized by a separate argument described in his brief as follows:

> . . . (1) a shareholder suing on behalf of a corporation may bring all suits which a corporation could commence but for the refusal of its officers and directors; (2) a corporation could commence a class action on behalf of all corporations similarly situated; and therefore (3) a shareholder, standing in the shoes of his corporation, may commence a class action on behalf of all corporations similarly situated.

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5. In the questions certified to us for appeal we do not reach the issue whether the individual derivative actions on behalf of the four funds in which appellee owns stock may be prosecuted as a class action or whether they must be pursued separately.

The fatal defect in this "champion of the industry" approach is that it seeks to equate a corporation's primary right of action with a shareholder's secondary right to bring a derivative action. To be sure, if the fund itself sought to bring a class action in behalf of other funds similarly situated, there would be no theoretical barrier prohibiting such a class action. But the fund is not the plaintiff in the case at bar, and the only right the individual derivative plaintiff possesses is a secondary one—a right which not only defines his standing to sue but also limits the extent of the possible recovery, i.e., the damage sustained by the corporation in which he is a shareholder. A secondary right is limited; it is co-extensive with plaintiff's need as a shareholder to protect an interest which allegedly has been impaired. And the very limitation that adheres conceptually in a derivative action is the bar which defeats appellee's attempt to qualify as the class representative for the other funds. A shareholder can only require a corporation to initiate a matter to protect the rights of a shareholder qua shareholder; he cannot force a corporation to bring a class action for the fundamental reason that whatever wrongs other corporations similarly situated have sustained are immaterial and irrelevant to a derivative plaintiff's limited and secondary cause of action. There may be injuries to the other corporations, but because appellee does not possess the stockholder relationship to them and the proprietary interest which accompanies this relationship, he may not qualify as their representative in a class action.

C

In view of our holding that appellee may not maintain a primary right of action against any of the mutual funds, Part A, *supra*, we are not convinced that a conflict of interest will be presented when we remand this case to the

district court for further proceedings on the derivative claims brought on behalf of the four funds in which appellee holds shares. Derivative claims, if successful, enforce a corporate cause of action, "[a]nd the relief which is granted is a judgment against a third party in favor of the corporation." *Price v. Gurney*, 324 U. S. 100, 105 (1945). That the corporation is named as a defendant does not, of course, change this result, for it is joined as a necessary party, only as a nominal or technical defendant, and any judgment obtained against the real defendant runs in its favor. *Meyer v. Fleming*, 327 U. S. 161, 167 (1946); *Knapp v. Bankers Security Corp.*, 230 F. 2d 717, 721 (3 Cir. 1956).

Moreover, we do not believe that appellee's attempt to bring primary suits against the funds is in and of itself sufficient to show interests antagonistic to them. Indeed, in the district court he relinquished any claim from monetary damages against the funds. In any event, we believe that sufficient safeguards exist under Rule 23(d) for the district court to take appropriate action during the course of the proceedings to guard against any conflicts of interests or disabling antagonisms which could possibly appear in the course of these proceedings. It has been said that a "full arsenal of adaptable methods is available to assure the fair and efficient conduct of the action."[6]

The judgment of the district court will be reversed except to the extent it permits appellee to maintain second-

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6. Rule 23(d), which sets forth various provisions for the making of appropriate orders in the course of a class action, restates the traditional powers of the court under prior law, although they were not spelled out in Rule 23 prior to the 1966 amendments. The catalogue of possible orders contained in Rule 23(d) is not exhaustive, as Rule 23(d)(5) leaves open the opportunity for orders "dealing with similar procedural matters." Further, the last sentence of Rule 23(d) provides that such orders may be combined with pretrial orders under Rule 16. Newberg, "Orders in the Conduct of Class Actions: A Consideration of Subdivision (d)," 10 Boston College, Ind. & Com. L. R. 577 (1969).

ary or derivative actions in behalf of the four mutual funds in which he owns shares, i.e., The Dreyfus Fund Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc., and The Putnam Growth Fund. The order of the district court which stayed all proceedings in that court will be vacated.

Judgment of the United States Court of Appeals for the Third Circuit Dated September 30, 1970.

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the orders of the said District Court, filed October 1, 1969, and December 18, 1969, be, and the same are hereby reversed, except to the extent said orders permit appellee to maintain secondary or derivative actions in behalf of the four mutual funds in which said appellee owns shares, that is The Dreyfus Fund, Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc., and The Putnam Growth Fund, in accordance with the opinion of this Court.

Attest:
Thomas F. Quinn
Clerk

September 30, 1970

Order of the United States Court of Appeals for the Third Circuit Dated September 24, 1970.

It is Ordered that the order of the District Court for the District of New Jersey, entered on December 18, 1969, which order stayed all proceedings in the above-entitled cause pending further order of this Court, be and hereby is vacated, in accordance with the opinion of this Court.

Attest:
Thomas F. Quinn
Clerk

September 24, 1970

Order Sur Petition for Rehearing of the United States Court of Appeals for the Third Circuit Dated October 30, 1970.

Present: Hastie, *Chief Judge*, Staut, Van Dusen, Wisdom, Aldisert and Gibbons, *Circuit Judges*.

The petition for rehearing filed by Joseph B. Kauffman, Appellee, in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

Ruggero Aldisert,
Judge.

Dated: October 30, 1970

Judge Freedman did not participate in the consideration of this case.

Amended Judgment of the United States Court of Appeals for the Third Circuit Dated November 12, 1970.

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here Ordered and Adjudged by this Court that the interlocutory orders of said District Court, filed October 1, 1969, and December 18, 1969, denying motions to dismiss, for lack of standing, appellee's actions as a shareholder in his own right under Section 4 of the Clayton Act against the four funds in which he holds stock; as a class representative under Fed. Civ. Pro. 23 of all similarly situated shareholders of sixty-five mutual funds; by virtue of his class representation of all similarly situated shareholders, derivatively on behalf of sixty-five mutual funds similarly situated; derivatively, under Fed. R. Civ. Pro. 23.1, on behalf of the four funds of which he is a shareholder; and derivatively on behalf of the four mutual funds as a class action on behalf of the sixty-one other funds similarly situated, these interlocutory orders having been certified to this Court and leave to appeal having been granted by this Court, in accordance with the provisions of 28 U. S. C. Sec. 1292(b), said orders be, and the same are hereby reversed, except to the extent that said orders permit appellee to maintain secondary or derivative actions on behalf of the four mutual funds in which said appellee owns shares, that is The Dreyfus Fund, Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc., and The Putnam Growth Fund; and the extent of the Court's review being so limited under the certification no decision is made on issues not so certified, including, inter alia, whether appellee may qualify as a class representative

under counts II and III, in accordance with the opinion of this Court.

Attest:
Thomas F. Quinn
Clerk

November 12, 1970

Certified as a true copy and issued in lieu of a formal mandate on November 18, 1970.

Test: Thomas F. Quinn

Clerk, United States Court of Appeals for the Third Circuit.